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STATEMENT OF

THE NATIONAL ASSOCIATION OF GOVERNMENT EMPLOYEES

BEFORE THE

HOUSE COMMITTEE ON POST OFFICE AND CIVIL SERVICE

ON

THE DESIGN OF A SUPPLEMENTAL RETIREMENT PROGRAM FOR
EMPLOYEES HIRED AFTER 1983

APRIL 23, 1985

The National Association of Government Employees, which is an affiliate of the Service Employees International Union, (AFL-CIO) is pleased to have this opportunity to present our views on selected issues in the development of a supplemental retirement plan.

The design of a retirement system for employees covered under Social Security is a task of historical importance to the Civil Service. The Committee faces many complex challanges in coordinating the divergent benefits provided by Social Security and CSRS in creating a system which will be fair and reasonable. The Committee recognized the difficulty of this task early in the process and elected to take a comprehensive approach to the design of such a system. To further public knowlege of the issues, the Committee has commissioned several studies by the Hay Higgins Associates, the General Accounting Office, and the Congressional Research Service. These studies have comprehensively spelled out the many considerations involved in the design of the plan. We applaud the Committee for it's foresight and leadership on this issue. We look forward to working with the Committee in addressing these complex and important questions, and to establish a supplemental which is fair to the new hires and consistent with the traditional objectives and goals of CSRS.

The Committee has requested our position on a series of issues relevant to the design of a new system including cost, Social Security tilt, employee contributions, funding and financing and vesting. We will address these matter in order.

COST

The cost of a pension plan is arguably the most important decision to be made in the shaping of a supplemental retirement plan. The primary purpose in calculating the cost of a pension system is to determine the funding levels needed to fullfill all benefit obligations. As a practical matter the decision regarding the cost of a pension system will frequently precede and determine questions of benefit design.

The Civil Service Retirement System is a quality pension plan comparable to that provided by our nation's largest employers. The CSRS has traditionally been government's most important device for the recruitment and retention of workers. Many current workers chose employment with the government in preference to higher paying private sector jobs because of the CSRS. Without the CSRS as a recruitment device the government will be much less attractive to many of our best and brightest workers.

The most commonly accepted measure used to represent the cost of a retirement system is the entry age normal cost. This figure measures the long term cost as a percentage of payroll needed to pay for the retirement benefits of a newly hired group of workers. It's noted that this figure is an estimate whose accuracy is contingent upon the prediction of a number of variables. The Congressional Research Service estimates that the current normal cost of the CSRS is 31.7% of payroll. Typically federal employees contribute 7% of their salaries so that the employers normal cost is 24.7% of payroll.We endorse this cost figure as an appropriate one for the supplemental retirement plan. Under these estimates the new plan should cost 18.6% of payroll so that when added to the 6.1% Social Security contribution would equal the current system cost.

As this Committee is well aware the design of the supplemental retirement plan should not take place in a vacuum but rather must be considered as part of an overall compensation package. The Hay/Huggins study on total compensation comparability performed for this Committee demonstrates that the total compensation of federal employees lags behinds the private sector by 7.2%. If the retirement benefits for new hire federal workers were reduced in value the comparability gap would be truly glaring and would further erode governement's recruitment efforts.

The N.A.G.E. strongly endorses the development of a supplemental plan which when combined with Social Security would provide comparable levels of benefits at a comparable cost to those currently provided under CSRS. The House leadership has endorsed this concept in a February 18,1983 letter signed by Speaker O'Neil, Chairman Ford, and Chairman Rostenkowski. This approach is the fairest, and most productive for the government, it's workers and it's taxpayers.

To the extent possible, benefit packages should be uniform and consistent for like groups of workers. It would heighten divisions in the workplace and further erode morale and productivity to provide the new hires with markedly different retirement benefits, or require different contributions to CSRS

We thus urge the development of a supplemental plan which will be comparable in benefit and costs to CSRS. As indicated the cost estimates available indicate that the cost to the government of such a supplementary plan would be 18.6% of payroll.

EMPLOYEE CONTRIBUTIONS

Historically the Civil Service Retirement System has required steep employee contributions which were fully taxed as income. By comparison the vast majority of private sector plans were 100% employer funded. In recent year many private sector employers have developed tax deferred savings plans which serve as an adjunct to the pension plan. Employee contributions to these plans are tax deferred. In addition the employer's contribution to a pension plan is also treated as a business expense and is not taxable as income to the employer. Thus, unlike the private sector there have been few incentives for the federal government to fully fund CSRS.

Currently most employees whether covered under the old or the new retirement system are paying 8.3% to either Social Security and medicare, or CSRS and medicare. As we have indicated in our testimony it is desirable to maintain consistency in benefit programs to the fullest extent possible including equality in employee contributions towards the retirement system. Thus we would urge that a 1.3% employee contribution rate be invoked for the supplemental plan.

Under this scheme all employees would be required to contribute 8.3% to their retirement plan. The only exception would be for those new hire employees earning more than the Social Security maximum taxable wage base. These employees currently pay 7% to Social Security only up to the $39,000 maximum taxable wage base. The excess amount over $39,000 are not taxable under Social Security. Thus for consistency sake the Committee might also consider requiring a 7% contribution for new hire employees on amounts in excess of the Social Security maximum taxable wage base.

SOCIAL SECURITY TILT

The Social Security system and CSRS have differing purposes which is reflected in their respective structures for benefit distribution. Social Security is in part a social insurance program which redistributes wealth from high to low income workers. By comparison CSRS is a staff retirement plan which replaces the same percentage of salary for workers at all income levels.

Thus under Social Security if an employee worked 30 years and earned $15,000 he will recieve $6,00 in benefits. If he earned $30,000 he would recieve $8,200 in Social Security benefits. If he earned $45,000, he'd recieve a $8,400. By, comparison under CSRS the employee earning $15,000 would recieve a $8,000 pension At $30,000 he'd recieve $16,000 in annuity income and at $45,000 he'd recieve $24,300.

In designing the supplemental retirement system Congress must decide to either completely offset pension dollars with social security dollars, ignore the social security benefit by simply adding the pension benefit on top of the social security benefit, or integrate the pension with social security so as to offset part of the tilt but not all of it.

If the plan were to completely offset social security, the result would be that lower paid federal workers would receive little of their total benefits from CSRS, and almost all their pension benefits from social security while the higest paid federal workers would recieve most of their total benefits from CSRS. It is noted that the IRS rules would not qualify a plan which fully offset social security benefits. Further, full intergration of this sort unfairly disadvantages lower paid workers to the advantage of higher paid workers.

On the other extreme, however, if the plan were designed so that its benefits were simply added on to social security then lower income workers would receive a higher percentage income than currently received under CSRS, while higher paid workers under the new system would receive smaller retirement benefits than comparably paid employees in the current system.

The third option is to partially integrate social security with pension benefits. Integration of this sort allows the design of a pension system with replacement rates across the entire range of income levels falling between offset and add on plans. The plan could be designed to offset the social security tilt at differing levels of income.

There are other factors to consider in designing the supplemental plan. To the degree possible it is desireable that pension plans be easy to administer, and easy to explain and most important easily understand by employees. In general the offset plans are more complex to administration since they require a determination of Social Security benefits. In addition the offset plans are more difficult for employee to understand, and hence make retirement planning more difficult to undertake. Thus there are additional disadvantages to an offset plan.

As an alternative to an offset plan the Committee might consider a tax deferred thrift plan. A tax deferred plan can address the social security tilt as effectively as an offset plan. In addition it is simpler to administer and understand. A thrift plan also encourages greater employee involvement in retirement planning by providing incentives to save and invest. A tax deferred plan would be of particular advantage to higher paid employees since they would have more cash to participate in a thrift plan, and would also recieve the greatest tax benefits.

In conclusion, a tax deferred thrift plan gives greater fexbility in retirement planning to all employees . Upper income workers however recieve the greatest benefits from a thrift plan. Thus a thrift plan provides an equitable and simple alternative for addressing the Social Security tilt.

FUNDING AND FINANCING

The evidence is clear and convincing that the current CSRS has adequate funds to meet the expected demands on the system for the forseable future. The annual OPM report shows, for instance, that current financing provisions will produce a growing fund each year for the next 75 years with no indication of any instability on the horizon.

OPM has devoted much effort into misleading the public about the financial status of the CSRS through use of it's figures on the unfunded liability in CSRS. The unfunded liability is a measure of the money that would have to be paid to the system today, in addition to existing and anticipated funds needed to cover the cost of all benefits that will be paid to employees over the next 75 years.

The concept of an unfunded liability is most frequently used in concert with private sector funding requirement under ERISA. These funding requirements are protections for the solvency of a pension fund against the risk that an employeer will go bankrupt. This concern is not relevant to the federal government since if it goes out of business federal employees will have much more pressing concerns than the fate of CSRS.

The current system is in adequate acturarial balance over the long term. There seems to be limited gains available in fully funding CSRS in the manner required under ERISA. In fact we would be concerned if there were amounts in excess of the actuarial required amounts needed to pay benefits that Congress in these days of rising deficits would seek to transfer those unused funds into general revenues. There is little that could be done to protect against this contingency since government, unlike business, can change the laws to suit it's needs.

The Committee might however require Agencies to continue to contribute 7% to the Fund for those employees covered under the supplemental plan. This would maintain a consistency in the Agency contribution to both the Supplemental, and the CSRS, and would decrease the share of the Fund's cost which is borne by general revenue transfers.

The most important "funding question" in the design of a supplemental plan is the demand to structure the mechanisms in such a manner so as to protect the benefits of current workers and retirees. The Supplemental cannot be funded in a manner which will jeapardise the benefits already accrued by current participants. Existing participants must be assured that government will honor it's committments represented in the current system.

The benefits of current workers can be best protected by maintaining the supplemental retirement eligible annuitants as part of the existing CSRS fund. All funds from both the current CSRS, and the supplemental should be stored in the Civil Service Retirement Fund. All contributions from the Agency, the employee, and general revenues should be made to the trust fund. Likewise all benefits should be paid from the trust fund. A unified trust fund would minimize the risk of stripping the CSRS when it becomes the minority plan, and provide the greatest assurances to participants that government will honor it's committments. Finally, to the degree possible, the CSRS Fund should be structured in a manner which will insulate it to the greatest degree possible from yearly partisan debates over the federal budget. Employees and retires need stability in their benefit packages so that they can plan accordingly. In current times this stability has been lacking as retirement packages have served as a convenient target for federal budget cutters.

There must be a recognition by the Congress that CSRS constitutes a contract between the federal government and it's workers which should not be easily altered because of budgetary demands.

VESTING

The CSRS vests employees in the system after 5 years of service. Employees are eligible for an unreduced pension at age 55 with 30 years of service, or at age 60 with 20 years of service or at age 62 with five years of service.

The pension benefits under CSRS have been designed to provide a comfortable and dignified retirement for those who invest the longest years of their career with the federal goverment. The CSRS has provided workers an incentive to remain with the government for their careers.

The five years vesting requirement had been particularly important to federal workers as there were no social security benefits which could be transferred to the next job as was common in the private sector. The circumstances which demanded five years vesting will no longer exist in the Supplemental as portability of benefits will be greatly enhanced.

The Supplemental will have increased portability of benefits through the addition of social security and a thrift plan. Social Security is designed for the maximum portability, and can be "transferred" from workplace to workplace. A thrift plan allows an employee to build equity which leaves with the worker. Thrift plans would also require a vesting period if there is a matching employer contribution.

In the private sector under ERISA an employer cannot require more than 10 years for vesting. The majority of these plans have chosen 10 years as the vesting period. A longer vesting period is advantageous in that it is less costly whereas a shorter vesting period allows greater flexibility to the employee and gives greater protection to workers who change jobs frequently or work for periods of their careers for employers without a pension plan.

The Committee should consider a vesting period within the period from five to ten years contigent upon the cost involved and the interrelationship with the other terms of the plan. The Committee might for instance consider a shorter vesting period on the thrift plan, with a longer vesting period on the annuity portion of the Supplemental. This would enhance portability while still providing an incentive for longer service.

UNIQUE EMPLOYMENT CATOGORIES

The Committee has indicated that it will hold an additional hearing wherein it will consider the retirement plans of employee in certain unique occupations. These employees include Air Traffic Controller, CIA, FBI, federal firefighters, hazardous duty employees, foreign service, legislative, and judicial employees.

The history of pension plans in general indicates that they were created as a valuable tool to both the employer, and the employee. Pensions allow employees to leave the job with income and dignity. A sound pension plan also allows the employer to create advancement opportunities for younger workers and allows for orderly transitions in the workplace. It allows the goverment to reinforce a certain type of career pattern for the good of the federal government.

There is no evidence that the circumstances which lead to the special retirement categories for any of these groups has been changed. We thus would support comparable benefits for these employees.